APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this title—

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(11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses;

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(U. S. C., Title 26, Sec. 101.)

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(a) *Imposition of Tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 13¾ per centum of the amount of its net income in excess of the credit provided in subsection (f) of this section;

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(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross Income.*—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22;

(2) *Net Income.*—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) *Investment Income.*—"Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) *Underwriting Income.*—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) *Premiums Earned.*—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the

taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) *Losses Incurred.*—"Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) *Expenses Incurred.*—"Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) *Deductions Allowed.*—In computing the net income of an insurance company

subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Subject to the limitation contained in section 117 (d), losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount received as dividends from corporations as provided in section 23 (p);

(8) The amount of interest earned during the taxable year which under section 22 (b) (4) is excluded from gross income;

(9) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (l).

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(e) *Double Deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

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(U. S. C., Title 26, Sec. 204.)

SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) *Application of Title.*—Mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this section.

(b) *Gross Income.*—Mutual marine-insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(c) *Deductions.*—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) *Mutual insurance companies other than life insurance.*—In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

(2) *Mutual marine insurance companies.*—In the case of mutual marine insurance companies, in addition to the deductions allowed in paragraph (1) of this subsection, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(3) *Mutual insurance companies other than life and marine.*—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide

for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

(U. S. C., Title 26, Sec. 207.)

Section 103 (11) of the Revenue Act of 1928, c. 852, 45 Stat. 791, and of the Revenue Act of 1932, c. 209, 47 Stat. 169, is identical with Section 101 (11), Revenue Act of 1934, *supra*.

Section 204 of the Revenue Acts of 1928 and 1932, except as to rate of tax in the 1928 Act, is substantially identical with Section 204, Revenue Act of 1934, *supra*.

Section 208 of the Revenue Acts of 1928 and 1932 is identical with Section 207, Revenue Act of 1934, *supra*.

Treasury Decision 4697, XV-2 Cum. Bull. 167 (1936) provides:

> Article 207-1 of Regulations 86 is hereby revoked and in lieu thereof there are hereby prescribed the following regulations:
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> Art. 207-1. *Gross income of mutual insurance companies other than life.*—The gross income of mutual insurance companies (other than life) consists of their total revenue from the operation of the business and of their income from all other sources within the taxable year, except as otherwise provided by the Act. Gross income includes net premiums (that is, gross premiums less returned premiums on policies canceled and premiums on policies not taken), investment income, profits from the sale of assets, and all gains, profits, and income reported to the State insurance departments, except income specifically ex-

empt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by mutual fire insurance companies should be treated in the same manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits, including such portion, if any, of the deposits as is not returned to the policyholders upon cancellation of the policies, must be included in the gross income. A net decrease in reserve funds required by law within the taxable year must be included in the gross income to the extent that such funds are released to the general uses of the company and increase its free assets. Any net decrease in reserves shall be added to the gross income, unless the company shall show that such decrease resulted from the application of reserves to the purposes for which they were established.

Art. 207–2. *Deductions allowed mutual insurance companies other than life insurance companies.*—Mutual insurance companies (other than life insurance companies) are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. As to life insurance companies, see sections 201–203 and articles 201 (a)–1–203 (c)–1. Insurance companies, other than mutual and life companies, are entitled only to the deduc-

tions allowed by section 204 (c). (See article 204 (c)–1.) Mutual insurance companies are not entitled to the deductions allowed by section 204 (c), but (except in the case of life insurance companies) are entitled to the deductions allowed by section 23. "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year.

Art. 207–3. *Required addition to reserve funds of mutual insurance companies.*— Mutual insurance companies, other than life insurance companies, may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. Reserve funds "required by law" include not only reserves required by express statutory provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, reinsurance, and unpaid brokerage. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-

premium" fund. For a general definition of "reserve fund" see article 203 (a) (2)–1. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guarantee surplus" fund or similar fund.

Art. 207–4. *Special deductions allowed mutual marine insurance companies.*—Mutual marine insurance companies should include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly forms part of the net income of the company, except to the extent that it is subject to the deductions allowed such insurance companies and other corporations.

Art. 207–5. *Special deductions allowed mutual insurance companies.*—Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and rein-

surance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

Art. 207–6. *Returns of insurance companies.*—Insurance companies transacting business in the United States or deriving any income from sources therein are required to file returns of income. The return shall be on Form 1120, except that life insurance companies shall make return on Form 1120L. As an aid in auditing the returns, wherever possible a copy of the re-

port to the State insurance department should be submitted with the return. Otherwise a copy of Schedule D, parts 1, 3, and 4, of the report should be attached to the return, showing the Federal, State, and municipal obligations from which the interest omitted from gross income was derived, and a copy of the complete report should be furnished as soon as ready for filing.

The above is substantially the same as Articles 1001–1015 of Treasury Regulations 74 and 77, promulgated under the provisions of the Revenue Acts of 1928 and 1932, respectively.

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